

Fixed income Better options

Secured and rated NCDs offer higher return and liquidity than FDs of banks and companies

India has one of the highest domestic savings rate in the world. As per a report released by the World Bank in 2011, the gross domestic savings in India stood at 31.53% in 2010. Though the savings rate in India is high, Indians are mostly inclined towards investing in physical assets like gold and real estate rather than financial assets like fixed deposits (FDs), equity shares or bonds. On an average, Indians invest 54% of their savings in physical assets and the remaining 46% in financial assets. FDs enjoy the lion's share (54%) of the investment in financial assets.

This shows Indians are conservative investors. But investing in bank FDs may not fetch the best return. There are various other options that can give investors better return than bank FDs with similar or slightly higher risk. One such option is the listed debentures or bonds of non-banking financial companies.

The retail debt market in India is in the developing stage. Volumes in the bond market are very low compared with those in the stock market or the wholesale debt market. This is because most investors in India prefer to hold bonds or debentures till maturity. Another reason is the lack of awareness among retail investors about prices of bonds. Investors mostly focus on the interest they



get. Not many know that the market price of bonds and debentures fluctuate daily. Very often the bond market offers very good opportunities in the short and the long term.

Shriram Transport Finance Company (STFC) had come up with a Rs 500-crore issue of non-convertible debentures (NCDs) in 2009 with a coupon rate of 11.5. The debentures were rated AA+ by credit rating agency Care. The issue got oversubscribed 10 times on the opening day as the company was paying around 1% to 2% higher return over that on the then prevailing FD rates. The company again came up with an NCD issue in 2011, which was oversubscribed in a couple of days. The coupon rates for different categories were between 11% and 11.65%.

Currently bonds of different maturities of STFC are available at attractive yields in the secondary market. The yield to maturity (YTM) of many debentures is higher than their coupon rates. For instance, the secured NCDs of STFC allotted on 12 July 2011 and maturing on 11 July 2014 are currently trading at YTM of 11.51% as against their coupon rate of 11.35%. Similarly, secured debentures by STFC allotted on 11 July 2011 and maturing on 11 July 2016 are available at a YTM of 11.73% as against the coupon rate of 11.35%.

These debentures can be very good investment options for those seeking decent rate of return on their investments. Those willing to take a little bit of additional risk over bank FDs can look at these options. Investors with a long-term horizon can hold these debentures till maturity to earn regular returns till maturity. Investors with a medium-term horizon may invest in these debentures with a view of one to two years. The interest rate cycle has reversed, with the Reserve Bank of India recently cutting its lending (repo) rate by 50 basis points to 8%. The market value of these debentures will go up as the rates drop further. Investors can pocket the gains and exit through the secondary market once interest rates come down substantially.

Secured NCDs enjoy various advantages compared with bank FDs. NCDs have assets backing them. In case of liquidation of a company, secured NCD holders are paid before depositors. Also, listed NCDs are not subject to tax deduction at source (TDS) and offer decent liquidity as they can be sold on the exchanges.

Though there is no TDS, investors opting for the cumulative option have to pay tax on the accrued interest during the year. If the NCDs were held for a less than a year and sold at a profit, the short-term capital gain is added to the income of the investors and taxed at the applicable rate of tax on his income. If the NCDs are held for more than one year, the profit will qualify for long-term capital gain. Thus, investors can pay tax at 10% or at 20% tax after applying indexation.

Unlike FDs, there is no penalty on interest if the NCDs are sold before maturity. Listed NCDs are rated, giving a clear idea about the risk involved in the investment. Also, the shares of these companies are also listed and investors can keep a track of their financial standing as they need to publish their results every quarter.

The risk involved in investing in NCDs is higher than in nationalised banks' FDs. But compared with the other options available in the market, which offer similar return, listed NCDs definitely score well. For instance, companies like Unitech, JP Associates and JP Infratach offer investors a return of 11% to 12% on their unsecured and unrated FDs. Fixed income investors looking for better return can definitely prefer secured and rated NCDs over banks FDs and unrated and unsecured FDs of companies.

—Rahul Mantri

Gains to be made after listing

Debentures trading at a discount to face value#

COMPANY	COUPON(%)	MATURITY DATE	MARKET PRICE(Rs)	RATING
Shriram Transport Finance Company Series NM	11.35	07-11-2016	995	AA+
Muthoot Finance Series N6	12.25	14-09-2016	977.99	AA-
Muthoot Finance Series N1	11.75	14-09-2013	995	AA-
Mannapuram Finance Series NCD3	12.20	09-08-2013	972.1	AA-
India Infoline Investment Services Series N1	11.70	18-08-2014	952.57	AA-
Religare Finvest Series NCD01C2	12.25	23-09-2016	983.89	AA-
Shriram City Union Finance Series N2	11.85	25-08-2016	962	AA
Rural Electrification	8.12%*	27-03-2027	998	AAA

As on 23 April 2012. Face value: Rs 1000. * REC offers tax-free interest at the rate of 8.12%. List not exhaustive.